CURRENT MUNICIPAL PRACTICES: PLANNING AND FINANCING INVESTMENTS IN INFRASTRUCTURE

Results of a Survey Conducted at The Conference on Financial Management And Development of Municipalities in The Czech Republic, September 1997

Prepared for

East European Regional Housing Sector Assistance Project
Project 180-0034
U.S. Agency for International Development, ENI/EEUD/UDH
Contract No. EPE-C-00-95-001100-00, RFS No. 403

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October 1997
UI Project 06610-403

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ABSTRACT

Municipalities continue to need and seek additional sources of financing for local capital investments. Municipalities in 1997 are more likely than they were in 1996 to prepare separate operating and investment budgets and to use advanced techniques to monitor and evaluate their financial condition. Larger municipalities showed more financial sophistication than smaller municipalities. Local officials appear to have become more cautious in 1997 in seeking loans from private lenders. This may reflect a prudent reaction by these officials at a time of difficult economic conditions in the country. Also, local officials continue to be unsure of their ability to negotiate successfully with private lenders. On the other hand, respondents generally expressed great confidence in their ability to prepare technically and financially sound investment projects.

Mayors, deputy mayors and chief financial officers from a large share of Czech municipalities attended the 1997 Conference on Financial Management and Development of Municipalities sponsored by the Union of Towns and Communities and the U.S. Agency for International Development. Participants were asked to respond to a short survey on current municipal practices in planning and financing capital investments. The survey instrument is the same one used at a similar conference in 1996. This makes it is possible to look at changes in prevailing practices from one year to the next. Respondents represented 30 percent of all municipalities with more than 5,000 inhabitants, and 70 percent of all municipalities with 50,000 or more inhabitants.

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INTRODUCTION

This report is based on analysis of a short survey conducted at the Conference on Financial Management and Development of Municipalities held in September 1996 and 1997. One objective is to assess the current level of knowledge of municipal officials and their experience with certain project analysis and financial management methods and tools. The survey further attempts to find out why municipalities are not employing certain methods. For example, if a respondent answers that the municipality does not prepare separate operating and investment budgets, the questionnaire asks whether this is because they do not know how to do this or because they do not think it is a desirable practice. A second important objective of the survey is to determine attitudes of local officials toward the use of credit to finance local capital investment projects.

DESCRIPTION OF SAMPLE

The same survey instrument was used in both years. However, this cannot be considered a panel survey because there was no attempt to interview the same people both years. In 1996, the survey was distributed to all participants at the Conference on Financial Management and Development of Municipalities, so it is possible that in several cases there were multiple responses from a single municipality. In 1997, one representative from each municipality at the conference was asked to respond to the survey.

The survey covers a large share of Czech municipalities. Table 1 shows that the 1997 sample included 30 percent of all municipalities with more than 5,000 inhabitants (79 out of 267) and 70 percent of all larger municipalities (16 out of 23).[1] In 1996, the sample was considerably larger because of more responses from smaller municipalities. The analysis in both years is limited to municipalities with populations of 5,000 or more inhabitants.

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[1] For this report, the term "smaller municipalities" will refer to municipalities with 5,000 to 49,999 inhabitants and the term "la
icipalities" will refer to municipalities with 50,000 or more inhabitants.

Table 1
Sample Size

	Number of Cities			
	In the Sample		In the Universe [a]	Percent Represented (1997)
City Population	1996	1997	Both Years	
5,000 to 9,999	50	31	135	23%
10,000 to 49,999	57	32	109	29%
50,000 to 99,999	7	10	16	63%
Greater than or equal to 100,000	9	6	7	86%
Total	123	79	267	30%

Note:
[a] The Czech statistics used in determining the universe had slightly different categories (for example, 5,001 to 10,000 and 10,001 to 50,000).

Survey respondents included mayors, deputy mayors, finance officers and other municipal officials (Table 2). As could be expected, smaller municipalities were more likely than the larger municipalities to be represented by a mayor. Mayors, finance officers and, to a lesser extent, deputy mayors constitute the bulk of the survey's respondents.

Table 2
Title of Respondent (Percent Distribution)

	Smaller cities	Larger cities	All cities
Mayor	44	13	37
Deputy Mayor	18	25	19
Finance Officer	34	44	36
Other	5	19	8
Total	100	100	100

THE NEED FOR ADDITIONAL FINANCING

The survey reveals that securing financing for investment projects is still a common problem. All but one respondent answered that they had prepared investment projects that they intended to include in the budget for 1996. Most of these respondents said that they were unable to carry out some of these projects. As in last year's survey, the primary reason given by respondents was a lack of financing. The second most common reason cited was technical, particularly among larger municipalities (Table 3).

Table 3
The Need for Additional Financing (Percent)

	Smaller Cities		Larger Cities	
	1996	1997	1996	1997
Municipalities that were unable to carry out one or more projects that they had planned for the prior year	92	95	94	94
Primary reason for not carrying out the projects (percent distribution)				
Financial	88	90	73	67
Technical	8	5	27	33
Political	1	2	0	0
Administrative	1	0	0	0
Other	2	3	0	0

Little has changed between 1996 and 1997. In 1997, two-thirds of the larger municipalities and 90 percent of the smaller municipalities cited financial obstacles as the primary reason for not carrying out projects in the prior year. This suggests that there is an extensive need for additional sources of financing for investments among municipalities of all sizes.[2]

PROJECT ANALYSIS AND CAPITAL BUDGET PLANNING

Compared with the earlier survey, it appears that a bigger share of larger municipalities used various methods for analyzing a project's feasibility in 1997 (Table 4). Larger municipalities are more sophisticated than smaller municipalities in that they had greater experience in all categories of project analysis. They also had greater knowledge of these methods.

2 Without a more in-depth survey, we cannot even speculate on the actual size of this financing need.

Table 4
Experience in Project Analysis

	Percent That Had Used Method			
	Smaller Cities		Larger Cities	
Method	1996	1997	1996	1997
Analysis of project financial feasibility	51	51	63	81
Analysis of project technical design options	41	29	50	56
Analysis of project environmental impact	45	43	50	81
Public hearings or surveys to determine the needs and priorities of local citizens	60	44	38	63
Analysis of the demand for the services to be provided by project	22	33	38	44
Any of the above-mentioned methods	82	76	69	100

Eighty-one percent of the larger municipalities had analyzed a project's financial feasibility and its environmental impact. More than half of the larger municipalities had also analyzed a project's technical design options and had conducted public hearings or surveys to determine priorities. The least commonly used method for project analysis was still formal demand analysis of the services to be provided by the project, although experience and familiarity appear to have grown since the last survey. More than forty percent of the respondents from the larger municipalities and a third from the smaller municipalities reported that their municipality had performed a demand analysis.

Thirteen percent (13 percent) of respondents from smaller cities did not indicate that they were familiar with any of the methods listed in the survey. A quarter of the respondents from smaller cities could not report that their municipality had actually used any of the methods. All of the respondents from the larger municipalities reported that their municipality had used at least one of the methods (See Annex I).

Table 5 clearly shows that in the past year the share of municipalities preparing separate operating and investment budgets has increased among cities in each population category. This is a good practice for all municipalities, particularly for those seeking credit financing. The likelihood of preparing separate operating and investment budgets still increases with the size of the municipality's population.

Table 5
Municipalities That Prepared Separate Operating and Investment Budgets

Population category	Percent	
	1996	1997
5,000 to 9,999	36	61
10,000 to 49,999	49	63
50,000 to 99,999	57	80
Greater than or equal to 100,000	89	100
Average for all municipalities	*47*	*67*

Overall, two-thirds of the municipalities prepared separate operating and investment budgets in 1996. The main reasons given by the 26 respondents whose municipality did not prepare separate operating and investment budgets are a lack of knowledge or time. Forty-three percent of those who did not prepare separate budgets indicated that they are not familiar with the practice or do not know how to apply it. Twenty-seven percent indicated that they had other higher priorities. Twelve percent of those who did not prepare separate budgets said they did not think it is desirable to prepare separate operating and investment budgets.

Table 6
Reasons Given for not Preparing Separate Operating and Investment Budgets, 1997

	Percent of Those That Did Not Prepare Separate Budgets		
Reasons	Smaller cities (N= 24)	Larger cities (N = 2)	All cities (N = 26)
Not familiar with the practice	33	50	35
Do not believe it is desirable to prepare separate operating and investment budgets	13	0	12
Know what it is, but do not know how to do it	8	0	8
Intended to do it, but had other higher priorities	25	50	27
Other reason for not preparing separate operating and investment budgets	21	0	19
Total	100	100	100

There are reasons to expect that elected officials (mayors and deputy mayors) would differ from non-elected officials (namely, finance officers) in their knowledge of and opinions concerning financial practices. In the smaller cities that did not prepare separate operating and investment budgets, fewer than one in five of the elected officials stated that they were familiar with the practice. This is in striking contrast with the non-elected officials from smaller cities that did not prepare separate operating and investment budgets. Over 70 percent of these non-elected officials stated that they were familiar with the practice. This difference in knowledge between elected and non-elected officials may correspond with their different attitudes towards private lending, as seen below.[3]

[3] All non-elected officials from larger municipalities reported that their municipality had prepared separate operating and investment budg
e could not compare familiarity with the practice between elected and non-elected officials where the separate budgets were not prepared.

FINANCIAL MANAGEMENT

Financial management practices among the larger municipalities appear to have improved between 1996 and 1997. The picture among smaller municipalities is mixed. (See Table 7 and Annex II.) The percent of larger municipalities that calculated their operating surplus or employed financial performance indicators to monitor and evaluate their financial condition was much greater in 1997 than in 1996. Among smaller municipalities the percent decreased in both these categories. Generally, the percent of larger municipalities using one or more of the methods increased from 69 to 94 percent from 1996 to 1997. Among smaller municipalities the percent decreased slightly from 78 to 76 percent. An interesting exception to this pattern is the use of credit ratings, which declined among larger municipalities during this same period. This may reflect a general trend toward a more conservative attitude about debt, as discussed in the next section.

Table 7
Experience in Monitoring and Evaluating the Municipality's Financial Condition

	Percent That Had Used Method			
	Smaller Cities		Larger Cities	
Method	1996	1997	1996	1997
Maintain financial condition indicators	57	49	50	75
Calculate operating surplus	51	43	38	81
Maintain local economic indicators	12	14	6	13
Maintain debt position indicators	23	32	31	44
Prepare alternative financial scenarios	16	30	19	44
Obtain an outside rating/ evaluation	3	3	19	6
Other method for monitoring financial condition	3	0	19	13
Any of the above-mentioned methods	78	76	69	94

CREDIT BORROWING

Municipal officials believe overwhelmingly that it is proper to borrow funds when necessary to finance investments in infrastructure. Only one respondent in either 1996 or 1997 indicated that a municipality should never borrow funds under any circumstance. There is much less agreement on the merits of borrowing from private lenders, although most officials seem to accept such loans as a valid option. Seventy percent of respondents in 1997 indicated that a municipality should borrow funds from private lenders if necessary to finance investment projects. The balance believe that municipalities should borrow only from the government on concessional terms.

Hesitancy to accept credit from private lenders appears to be higher in 1997 than in 1996, particularly among local elected officials (23 to 32 percent between 1996 and 1997) (Table 8). Interestingly, it appears that elected officials in larger cities may have tipped the balance. In the larger cities, one in three of the elected officials and only one in five of the non-elected officials believed that borrowing should only be on concessional terms from the government. In smaller cities, the difference was not as striking: 32 percent of elected officials and 29 percent of non-elected officials said that municipalities should not borrow from private lenders.[4] Although finance officers appear to be slightly more open than elected officials to borrowing from the private sector, acceptance among for this option also declined between 1996 and 1997.

Table 8
Opinion on Whether Municipality Should Borrow Funds to Finance Investments in Infrastructure (Percent Distribution)

[4] The one respondent who thought that municipalities should never borrow was an elected official from a smaller municipality.

	Elected Officials		Non-elected Officials	
	1996	1997	1996	1997
Municipality should never borrow funds from any source	0	2	0	0
Municipality should borrow funds only on concessional terms from the government	23	30	22	27
Municipality should borrow funds from private lenders when it needs additional funds for investment projects	77	67	79	74
Total	100	100	100	100

Table 9 shows the reasons given for not borrowing from private lenders by respondents who reject borrowing of any sort or who believe in borrowing only on concessional terms from the government. Both elected and non-elected officials in this group are likely to cite the cost and affordability of the loans as a major reason for not borrowing from private lenders. The risk inherent in such loans also appears as a frequent response, although more so among elected than non-elected officials. These are responses that would be expected from local officials who do not agree that it is appropriate to borrow from private lenders. Non-elected officials also seem to believe that private debt constitutes an unfair burden to future elected officials. Such a response would be consistent with a concern for the cost and risk of loans from private lenders. It also suggests that some non-elected officials may not agree with the decisions taken in their municipality regarding loans from private lenders.

It is not bad or wrong for local officials to have a healthy respect for the risks and costs inherent in obtaining credit from private lenders. Some municipalities probably should not be borrowing from private lenders given their current financial condition. What would be unfortunate is if a growing number of local officials were to decide *a priori* not to consider private capital markets as a potential source of financing for local capital investment projects. Unfortunately, the survey did not include a question that might help explain why a higher proportion of respondents expressed this view in 1997 than in 1996. It would useful if some organization, such as the Union of Towns and Communities, decided to explore in greater depth the trend in attitudes of local officials toward the use of credit to finance capital investments.

Table 9
Reasons for Preferring Not to Borrow from Private Lenders (Percent)*

	Elected Officials		Non-elected Officials	
	1996	1997	1996	1997
Too risky	71	57	31	44
Too expensive/ cannot afford the debt service	43	64	62	56
Unfair to burden future elected officials with debt	29	29	62	56
Do not have the knowledge or skill to borrow from private lenders	21	29	23	11

Note:
Percents do not add up to one hundred because respondents could give both a primary and secondary reason.

SELF-ASSESSMENT

At the end of the survey, respondents were asked to rate their ability to plan and finance investment projects. Over 90 percent of the respondents felt very confident or reasonably confident in this ability, with a third saying that they felt very confident. This year, a relatively higher share of finance officers said that they felt very confident (41 percent compared to 25 percent for elected officials).

Respondents also chose two areas in which they felt most confident and two areas in which they felt least confident. As indicated in Table 10, both elected and non-elected officials felt most confident in preparing financially sound projects. The aspect of planning investment projects in which elected officials felt the next-to-most confident was preparing technically sound projects, while non-elected officials felt more confident in preparing a capital budget. Most elected and non-elected officials felt the least confident in competing for subsidies, perhaps reflecting a changing and unsure relationship with the central government. Negotiating with private banks was also an area in which both groups felt less confident.

Table 10
Confidence Levels in Various Aspects of Planning and Financing Investment Projects (Percent Responses)*

	Most Confident		Least Confident	
	Elected official	Non-elected	Elected official	Non-elected
Preparing financially sound projects	68	62	18	24
Preparing technically sound projects	50	35	21	12
Preparing a capital budget	39	56	16	18
Competing for subsidies	30	26	66	85
Negotiating with private banks	7	18	50	44

Note:
Percents do not sum to one hundred because respondents could give two answers for both areas in which they felt most confident and areas in which they felt least confident.

ANNEX I

EXPERIENCE IN PROJECT ANALYSIS (PERCENT)

	Smaller Cities		Larger Cities	
Method	Heard of Method	Has Used Method (percent of those who have heard)	Heard of Method	Has Used Method (percent of those who have heard)
Analysis of project financial feasibility	73	51 (70)	94	81 (87)
Analysis of project technical design options	51	29 (56)	69	56 (82)
Analysis of project environmental impact	64	43 (68)	88	81 (93)
Public hearings or surveys to determine the needs and priorities of local citizens	76	44 (58)	88	63 (71)
Analysis of the demand for the services to be provided by project	52	33 (64)	63	44 (70)
Any of the above-mentioned methods	87	76 (87)	100	100 (100)

ANNEX II

EXPERIENCE IN MONITORING AND EVALUATING THE MUNICIPALITY'S FINANCIAL CONDITION (PERCENT)

	Smaller Cities		Larger Cities	
Method	Heard of Method	Has Used Method	Heard of Method	Has Used Method
Maintain financial condition indicators	71	49	75	75
Calculate operating surplus	68	43	88	81
Maintain local economic indicators	22	14	13	13
Maintain debt position indicators	51	32	44	44
Prepare alternative financial scenarios	37	30	50	44
Obtain an outside rating/ evaluation	38	3	44	6
Other method for monitoring financial condition	2	0	13	13
Any of the above-mentioned methods	94	76	94	94